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Nos. 85-1190 and 85-1207

In the Supreme Court of the United States

OCTOBER TERM, 1985

ASSOCIATED GAS DISTRIBUTORS AND PUBLIC SERVICE COMMISSION OF NEW YORK, PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION

TRANSCONTINENTAL GAS PIPE LINE CORP., ET AL., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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QUESTION PRESENTED

Whether the Federal Energy Regulatory Commission acted reasonably in determining that, under the Natural Gas Policy Act of 1978, the "price" at which natural gas is sold does not include the value to the seller of free or below-cost transportation provided by a pipeline company-purchaser for components of the gas stream retained by the seller.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-28a) is reported at 769 F.2d 1053.[1] The order of the Federal Energy Regulatory Commission (Pet. App. 29a-50a) is reported at 22 F.E.R.C. ¶ 61,013. The Commission's order on rehearing (Pet. App. 51a-77a) is reported at 24 F.E.R.C. ¶ 61,004.

[1]References to "Pet. App." are to the appendix to the petition in No. 85-1207.

JURISDICTION

The judgment of the court of appeals was entered on August 19, 1985, and petitions for rehearing were denied on October 17, 1985. The petitions for a writ of certiorari were filed on January 15, 1986. This Court's jurisdiction is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The raw stream of natural gas that flows out of the ground at the wellhead often is a mixture of substances that includes a variety of hydrocarbon compounds other than the natural gas itself. Gas producers generally sell their natural gas to a pipeline company at the wellhead, but frequently retain ownership of the other hydrocarbon compounds for subsequent sale to other buyers. These other hydrocarbon compounds are referred to as "liquids and liquefiables." Pet. App. 29a-30a & n.1.

The natural gas sales contract between a gas producer and a pipeline company typically sets forth the price for the natural gas (expressed as a specific dollar amount or as a formula), and contains in addition a specification of the quantity and quality of natural gas to be delivered under the contract, a term setting forth the duration of the agreement, and provisions describing the other responsibilities of the two parties. Pet. App. 34a-35a; 7 H. Williams & C. Meyers, *Oil and Gas Law* § 741.1 (1981); see also 4 H. Williams, *Oil and Gas Law* §§ 720-737 (1985). The contract also may impose on the pipeline-purchaser the additional obligation of transporting the liquids and liquefiables (ownership of which has been retained by the producer) along with the natural gas purchased by the pipeline. Pet. App. 24a, 33a.[2]

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[2]This arrangement is advantageous to the producer because it would be uneconomical to construct at each wellhead facilities to separate the liquids and liquefiables from the natural gas. For similar reasons, it would be impractical to construct a second pipeline system to transport these substances. Pet. App. 33a.

The price that a gas producer may charge for certain categories of natural gas is regulated by the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. 3301 *et seq.*, which sets forth ceiling prices for a "first sale" of natural gas. See *Public Service Commission* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 333-334 (1983).[3] The statute prohibits sellers of natural gas from charging a price greater than these ceiling prices (15 U.S.C. 3414(a)(1)). The present case concerns the interrelationship between these statutory maximum prices and contract provisions requiring a pipeline-purchaser to provide free or below-cost transportation for liquids and liquefiables owned by the gas producer.

This proceeding was initiated in 1981 when several parties, including petitioners, filed petitions with the Federal Energy Regulatory Commission seeking a declaratory order regarding the method of calculating the price at which natural gas is sold for purposes of ascertaining whether the sales price exceeds the applicable statutory ceiling price. The specific issue raised by the petitions was whether the express price set forth in a sales contract must be adjusted upward when the contract requires the pipeline-purchaser to provide free or below-cost transportation for liquids and liquefiables owned by the gas producer.

The Commission concluded (Pet. App. 50a) that "the value or cost of the service performed by the pipeline-purchaser in transporting liquid and liquefiable hydrocarbons on behalf of a producer-seller is not a component part of the maximum lawful prices subject to regulation under [the NGPA]." The Commission observed that the term "price" was not defined in the NGPA (Pet. App. 32a) and referred to the prior regulatory practice under the Natural Gas Act to give content to that term in the present context.

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[3]Price controls have been eliminated for some categories of natural gas sales. See 15 U.S.C. 3331.

The Commission stated that its previous regulation of the rate at which natural gas was sold to pipelines did not include regulation of agreements between gas producers and pipelines regarding the transportation of liquids and liquefiables. The Commission instead simply ensured that gas consumers did not bear the cost of transportation of liquids and liquefiables. Thus, the effect of the Commission's action "in almost all cases [was] to leave the consideration to be paid for the transportation and handling of [liquids and liquefiables] to private contractual negotiation between the parties, but to rely upon its pipeline rate authority to assure that these costs would not be subsidized by natural gas customers" (*id.* at 37a (footnote omitted)).

The Commission determined that the enactment of the NGPA did not evince any congressional intent to alter this regulatory approach. Since the cost of transporting liquids and liquefiables previously had not been regulated as part of producer-pipeline natural gas sales transactions, the Commission concluded that Congress did not intend to require that these costs be considered in calculating the "price" received for natural gas by the producer for purposes of assessing whether the transaction complied with the price ceiling established by the NGPA. Pet. App. 37a-39a.

The Commission further determined that its interpretation of "price," as used in the NGPA, was consistent with Congress's intent to establish a regulatory scheme that did not require review by the Commission of each individual natural gas sales contract. If the price of natural gas were adjusted to account for the value of the transportation of liquids and liquefiables "for every producer first sale the Commission would have the extraordinary difficult task of determining the value of the transportation service received by the producer to determine whether this amount, when

added to the monetary consideration, exceeds the applicable * * * maximum lawful price" (Pet. App. 42a). That result, the Commission found, would be directly contrary to Congress's attempt "to avoid uncertainty and delay by generally pricing gas at the wellhead in simple dollar amounts" (*id.* at 44a (footnote omitted)).

At the same time, the Commission made clear that the scope of its declaratory order was quite narrow. It observed that "unusual contractual arrangements could be structured solely for the purpose of evading the * * * price ceiling" and stated that such arrangements would be regulated under the Commission's enforcement authority (Pet. App. 41a n.21). In denying petitions for rehearing, the Commission reiterated that its order rested upon the fact that the "arrangements [regarding transportation of liquids and liquefiables] are a traditional part of pipeline-producer contracting practices" (*id.* at 62a). The Commission stated that it might reach a different result if presented with the question whether a non-traditional contract provision constituted a component of the price of natural gas.

2. The court of appeals unanimously affirmed the Commission's order (Pet. App. 24a-26a). The court observed that the Commission "has had a longstanding policy of requiring that the pipelines not allocate the[] costs [of providing transportation for liquids and liquefiables] to the consumer in their rate proceedings" (*id.* at 26a). Since the pipelines would be required to absorb these costs themselves, and could not pass along the costs to natural gas consumers, the court concluded that it was not "unreasonable or inconsistent with the purposes of the NGPA to require the pipelines to adhere to their contracts, provided adequate protection of the above-described policy is assured" (*ibid.*). The court determined that it was appropriate to "defer to the Commission's reading of the statute" because the court was "unpersuaded that the Congress

intended to require the Commission to consider this particular service as part of the price" of the natural gas (*ibid.*).[4]

ARGUMENT

Petitioners misstate the scope of the Commission's order. Petitioners assert that the Commission declared that it "will, as a general rule, ignore non-monetary consideration" in determining whether a gas producer has received a price greater than the statutory maximum price (85-1207 Pet. 3), but in fact the Commission expressly limited the scope of its order to whether the price of natural gas must be adjusted to take account of free or below-cost transportation of liquids and liquefiables. In concluding that such an adjustment is not required, the Commission relied upon considerations specifically applicable only to that narrow question, including the need for efficiency in determining price and for consistency with prior and anticipated future regulatory practice. And the Commission cautioned that a different rule might apply with respect to other non-monetary consideration received by gas producers (Pet. App. 41a n.21, 62a). The decision of the court below affirming the Commission's narrow order is correct and does not conflict with any decision of this Court or another court of appeals. Further review by this Court is not warranted.

1. The Natural Gas Policy Act of 1978 (NGPA) "replace[d] the Commission's authority to fix rates of return to gas producers according to what is 'just and reasonable' with a precise schedule of price ceilings" applicable to "first sales" of certain types of natural gas. *Public Service Commission* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 334

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[4]The court of appeals also affirmed in substantial part orders issued by the Commission relating to recovery by natural gas producers of production-related costs (Pet. App. 6a-24a) and concluded that another issue relating to recovery by pipelines of costs of transporting liquids and liquefiables was not yet ripe for review (*id.* at 27a-28a).

(1983); 15 U.S.C. 3331.[5] The statute prohibits sales of natural gas "at a first sale price in excess of any applicable maximum lawful price under [the NGPA]" (15 U.S.C. 3414(a)(1)). In order to determine whether a particular sale complied with these price ceilings, it is of course necessary to calculate the price at which the natural gas was sold. The question in this case is whether the price set forth in the express price term of a sales contract must be adjusted to account for any value received by the producer-seller as a result of the pipeline-purchaser's agreement to transport liquids and liquefiables owned by the producer-seller together with the natural gas purchased by the pipeline.

The NGPA does not prescribe the method for ascertaining the sales price of natural gas; indeed, the statute does not define the term "price." But Congress expressly authorized the Commission to administer the NGPA and "to define, by rule, accounting, technical, and trade terms" used in the NGPA (15 U.S.C. 3411(a) and (b)).[6] Since "the statute is silent * * * with respect to the specific issue" presented here, the question before this Court is whether the order issued by the Commission—the agency expressly charged with administering the statute—is "based on a permissible construction of the statute." *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council,* 467 U.S. 837, 843 (1984) (footnote omitted). The Commission's determination must be "given controlling weight unless [it is] arbitrary, capricious, or manifestly contrary to the statute." *Id.* at 844 (footnote omitted);

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[5] A "first sale" is defined generally as a sale of natural gas to a pipeline company or a sale preceeding the sale of the gas to a pipeline company. 15 U.S.C. 3301(21).

[6] Although the Commission's action was denominated a declaratory order rather than a rule, the parties had the benefit of notice and an opportunity to comment. Petitioners have not raised in this Court any procedural challenge to the Commission's action.

see also *Chemical Manufacturers Ass'n* v. *Natural Resources Defense Council,* No. 83-1013 (Feb. 27, 1985), slip op. 8-9. The Commission's determination that the express contract price should not be adjusted in these circumstances, and that pipelines accordingly will not be relieved of contractual obligations to carry liquids and liquefiables at less than cost, plainly satisfies this standard of review.

a. As the Commission observed in its opinion (Pet. App. 35a-39a, 57a-59a), regulatory practice prior to the enactment of the NGPA is relevant in defining the price of a sale of natural gas because Congress enacted the NGPA "in the context of prevailing practices under the Natural Gas Act." Pet. App. 34a (footnote omitted); see also *Public Service Commission* v. *Mid-Louisiana Gas Co.,* 463 U.S. at 327-338 (interpreting NGPA by reference to prior regulatory scheme); *Process Gas Consumers Group* v. *United States Department of Agriculture,* 657 F.2d 459, 464-466 (D.C. Cir. 1981) (interpreting term in NGPA in accord with prior regulatory policy).

During the pre-NGPA period, in establishing "just and reasonable" rates for gas producers pursuant to its authority under the Natural Gas Act (see 15 U.S.C. 717c), the Commission typically did not consider the provision of free or below-cost transportation services to gas producers as a factor relevant to the producer's price for natural gas; the Commission's regulatory scheme generally did not provide for any adjustment to wellhead prices when a pipeline agreed to provide such transportation services. The Commission's policy "was, in almost all cases, to leave the consideration to be paid for the transportation and handling of [liquids and liquefiables] to private contractual negotiation between the parties" (Pet. App. 37a (footnote omitted)). And when reviewing pipeline rates under this same statutory authority, the Commission continued to distinguish between the amount paid by the pipeline for natural gas and

these transportation costs. The Commission determined the percentage of transportation costs attributable to the liquids and liquefiables and barred the pipeline from charging its natural gas customers for those costs. This practice ensured that natural gas customers would not be charged for transportation costs unrelated to natural gas. *Mobil Oil Corp.* v. *FPC*, 483 F.2d 1238, 1243 (D.C. Cir. 1973); Pet. App. 37a.[7]

The Commission's decision in the present case simply continues its prior regulatory approach. The transportation costs are considered separately from the natural gas price charged by the gas producers, and the Commission utilizes

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[7]Immediately prior to the enactment of the NGPA, the Commission used the basic approach of requiring the pipeline to ensure that the transportation costs were not allocated to natural gas customers. See *Tennessee Gas Pipeline Co.*, 38 F.P.C. 691, 698 (1967) (cost allocation a "firm Commission policy"); *High Island Offshore System*, 55 F.P.C. 2674, 2686, reh'g granted in part, 56 F.P.C. 725, 732 (1976). Petitioners thus are in error when they claim (85-1207 Pet. 6) that pipeline cost allocation did not exist prior to passage of the NGPA.

In the early days of producer wellhead rate setting, the Commission would sometimes adjust a producer's wellhead price downward to reflect the receipt of the transportation services. See *Continental Oil Co.*, 27 F.P.C. 96, 108 (1962). However, this producer rate adjustment—in essence the approach petitioners advocate here—ended with the initiation of the Commission's pre-NGPA area and nationwide producer rate regulations in the early 1970's.

For a short period in 1971 and 1972 the Commission pursued a third alternative, requiring pipelines to charge producers a specific rate for these transportation services. This approach first was implemented by settlement in one gas producing area. *Southern Louisiana Area*, 46 F.P.C. 86, 139 (1971), aff'd *sub nom. Placid Oil Co.* v. *FPC*, 483 F.2d 880 (5th Cir. 1973), aff'd *sub nom. Mobil Oil Corp.* v. *FPC*, 417 U.S. 283 (1974). The Commission subsequently attempted to impose this approach nationwide, but its rule was vacated on judicial review. See *Mobil Oil Corp.* v. *FPC*, 483 F.2d 1238 (D.C. Cir. 1973). Thus, petitioners again err in asserting (85-1207 Pet. 6 n.8) that this approach constituted the pre-NGPA regulatory practice; the approach in fact had been abandoned five years before enactment of the NGPA.

its regulatory authority under the Natural Gas Act to ensure that pipelines may not pass along to their natural gas customers any costs attributable to the transportation of liquids and liquefiables. Since these transportation costs were not considered part of the producers' price when those prices were regulated under the Natural Gas Act, there is no reason they should be included in the "price" under the NGPA regulatory scheme.

The Commission's decision also rests upon the relationship between the construction of "price" and the deregulation of natural gas prices (see 15 U.S.C. 3331). In a deregulated transaction, the rule urged by petitioners would impose upon natural gas customers what the Commission considered to be an unfair burden: pipelines would be permitted to pass along these transportation costs to their natural gas customers because the NGPA permits a pipeline to recover "any amount paid in any first sale of natural gas." See 15 U.S.C. 3431(b)(1)(A) and (c)(2). As the Commission observed (Pet. App. 68a (emphasis in original)), if the " 'amount paid' [for natural gas] includes the cost or value of liquids and liquefiables transportation service as petitioners allege, then *upon deregulation,* because the maximum lawful ceiling prices would cease to operate, this *entire* cost could automatically be passed through to gas customers of the pipeline, even though they may derive only a *partial* benefit from the transportation service, and even though the value or cost of the service may be *greater* than the cost of the gas." That result would conflict with the established principle that the Commission must "assure that users of gas are not asked to pay for the transportation of a commodity they are not using" (*Mobil Oil Corp.* v. *FPC*, 483 F.2d at 1249). There is no evidence that Congress intended

to abrogate this principle in enacting the NGPA. See Pet. App. 38a.[8]

b. The Commission's decision also accords with the basic statutory purpose of eliminating regulatory delay and uncertainty with respect to natural gas prices. In enacting the NGPA, Congress "explicitly establishe[d] an incentive pricing scheme that is wholly divorced from the traditional historical-cost methods applied by the Commission in implementing the [Natural Gas Act]" (*Public Service Commission* v. *Mid-Louisiana Gas Co.*, 463 U.S. at 333). This price structure was designed to promote production by reducing the regulatory burden generally; Congress particularly sought to eliminate gas producers' uncertainty about prices stemming from both regulatory delay and the Commission's emphasis upon historic costs. *Id.* at 331; H.R. Rep. 95-496, 95th Cong., 1st Sess. Pt. 4, at 96 (1977).

Petitioners' proposed interpretation of the NGPA would require the Commission to assign a dollar value to the transportation services for liquids and liquefiables provided under each individual natural gas purchase agreement (Pet. App. 42a-43a).[9] Even if the calculation of such a value were

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[8]Petitioners characterize (85-1190 Pet. 6-7) the Commission's decision as resting upon the conclusion that the statutory maximum prices may be disregarded because consumers will be protected under another statute. While this consumer protection certainly is important, petitioners have misapprehended the thrust of the Commission's decision. The Commission found that the past treatment of these costs, which was based on the goal of consumer protection, indicated that Congress could not have intended to include these costs within the definition of the price of natural gas.

Petitioners make essentially the same error in claiming (85-1190 Pet. 7-8) that the Commission's decision improperly increases the maximum prices established by statute. The decision simply gives content to the term price as it is used in the statute.

[9]This problem is exacerbated by the existence of two different methods for determining this value—calculating the actual cost to the

possible, the Commission would be required to engage in lengthy administrative proceedings to develop historic costs—the very practice that Congress sought to avoid in enacting the NGPA. As a result, uncertainty and regulatory delay would be reintroduced into natural gas pricing (Pet. App. 43a, 61a). The Commission correctly concluded (*id.* at 44a) that "[t]his massively complex system of costing and valuing every quantum of consideration was plainly not intended by Congress which generally sought in [the NGPA] to spur production by setting non-cost-based, incentive ceiling prices at the wellhead."[10]

Congress simply could not have intended to "require that the Commission assign a dollar value or cost to *all* the separate non-price aspects of the relationship between a gas producer and its buyer" (Pet. App. 43a (emphasis in original)), and the Commission therefore must be free to establish some limitation upon the definition of "price" for purposes of ascertaining compliance with the maximum price provisions of the NGPA. For the reasons discussed above,

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pipeline or assessing the benefit conferred upon the gas producers in view of the cost of alternative transportation methods. Pet. App. 33a-34a, 43a.

[10]Petitioners argue (85-1190 Pet. 5; 85-1207 Pet. 12) that the statutory definition of a "sale" as "any sale, exchange, or other transfer for value" (15 U.S.C. 3301(20)) is relevant in defining price. But the fact that a sale is defined as any "transfer for value" does not mean that "price" must be defined to include all non-monetary consideration.

Petitioners also contend (85-1207 Pet. 15) that the specific exclusion of state severance taxes and certain other costs from the calculation of the sales price (see 15 U.S.C. 3320) indicates that the Commission's order is erroneous. But nothing in the statute or the legislative history indicates that Section 3320 was intended to set forth an exclusive list of the items to be excluded in defining price, or that the provision otherwise limits the Commission's authority to define price.

the Commission, while reserving the right to take other non-monetary terms into account where circumstances warrant, correctly determined that the transportation services at issue here do not constitute an element of the price of natural gas within the meaning of the NGPA.

2. Petitioners challenge the Commission's determination on a variety of grounds, all of which are without merit. First, petitioners argue (85-1207 Pet. 11-12) that the term "price" ordinarily encompasses all consideration received by the seller under a sales contract. But while "consideration" includes all of the promises made by one contracting party to the other, the term "price" has a more limited meaning, referring to the value assigned to the subject of the contract and not including, for example, agreements with respect to transportation arrangements, insurance and risk of loss, warranties, and similar matters. Moreover, the Commission properly interpreted this statutory term by reference to prior regulatory practice and Congress's purposes in enacting the NGPA (see pages 8-12, *supra*). Finally, Congress specifically authorized the Commission to administer the statute; because the Commission's definition is not "arbitrary, capricious, or manifestly contrary to the statute" it should be given "controlling weight" (*Chevron U.S.A. Inc.* v. *Natural Resources Defense Council,* 467 U.S. at 844 (footnote omitted)).

Second, petitioners argue (85-1207 Pet. 16-18) that the Commission's definition of price improperly preempts state law. Petitioners did not present this argument to the Commission or the court of appeals and therefore may not raise it before this Court. *United States* v. *Lovasco,* 431 U.S. 783, 788 n.7 (1977); *Adickes* v. *S.H. Kress & Co.,* 398 U.S. 144, 147 n.2 (1970); see also *Ecee, Inc.* v. *FERC,* 611 F.2d 554, 559-566 (5th Cir. 1980). Moreover, the argument is based entirely on the spurious assumption that Congress intended "price" to be defined by reference to state law, and

there is no evidence that Congress so intended. The argument also assumes that the Commission's construction of the statute somehow will interfere with state law. However, the Commission's order simply applies federal law to define a term in a federal statute; it does not in any way alter the state law rules of construction otherwise applicable to natural gas sales contracts. There simply is no preemption issue in this case.[11]

Third, petitioners argue (85-1190 Pet. 6; 85-1207 Pet. 7) that the Commission's order permits gas producers to avoid the maximum prices established in the NGPA, but this is only another way of asserting that the Commission erred in defining "price." The Commission's decision was extremely narrow, applying only to the specific transportation costs that had been excluded from the definition of price under prior regulatory practice, and the effect of the Commission's decision is only to avoid relieving pipelines of what may have been improvident promises to provide transportation services whose cost the pipeline companies must absorb and may not pass on to their natural gas customers. Petitioners' attempt to elevate the Commission's narrow decision (see Pet. App. 41a n.21, 62a) into a broad determination to ignore all non-monetary consideration is wholly without merit.[12]

In the final analysis, the Commission's order simply represents a continuation of past regulatory policy, not a novel administrative development. It is consistent with the

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[11]Petitioners similarly argue (85-1207 Pet. 13-14) that the Commission's order interferes with the contractual rights of the parties to these contracts. However, the order permits buyers and sellers to enter into any contract permissible under the NGPA.

[12]Indeed, petitioners themselves cite (85-1207 Pet. 10 n.18) several documents indicating that other sorts of non-monetary consideration might be considered to be components of the price of natural gas.

existing practices in the industry, Congress's intent in enacting the NGPA, and common sense. The court of appeals therefore correctly upheld the Commission's order.

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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